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The Role of Public Auditors in Fraud Detection - A Critical Review

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Abstract

The need for independent audit goes back to the agency theory, the theory of delegation of power and the issue of trust. Stakeholders delegate power to management to manage the business on their behalf, yet they face the risk of information asymmetry and management motivations to commit fraud. The main aim of having an independent auditor was therefore to reduce the risk of information asymmetry and fraudulent behaviour by management. Auditors are required by the International Auditing Standards to detect material fraud and error, and they are expected to have a duty of care for stakeholders. However, recently independent auditors, whether conducting private or public audit, have been scrutinised for failing to detect material fraud. There have been a lot of discussions in the literature about the role of private auditors in detecting fraud, but very little discussions about the role of public auditors in detecting fraud. This chapter will outline the difference between private audit and public audit; explain the legal liability of public auditors in relation to fraud detection; the role of public auditors in detecting fraud; and will critically review the root causes for auditors' failure to detect fraud.

1. Understanding the Difference between Private Audit and Public Audit

Before considering the difference between private and public auditors, it is important to explain the meaning of auditing and the role of auditors. Auditing could be defined as “the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria”. To do an audit, there must be information in a verifiable form and some standards or criteria by which the auditor can evaluate the information. Information could either be quantitative such as financial statements or qualitative such as effectiveness of an organisation's internal control system or operations. The criteria and methods for evaluating information vary depending on the information being audited. For example, in the audit of financial statements, the established criteria would be the accounting standards. For more subjective information, auditors and the organisations being audited normally agree on the criteria well before the audit starts (Arens *et al.*, 2014, p.24).

The word “auditor” refers to an independent competent expert whose role is to provide an unbiased professional opinion on the reliability of the information, processes, or systems being audited. Audit is one of the types of assurance services that is meant to increase the quality and the level of trustworthiness or legitimacy of the information provided. In order for auditors to provide an unbiased, professional and qualified opinion, they need to base their assessment on

reliable, relevant, and sufficient evidence (Arens et al., 2017). This applies to all types of auditors, whether private or public. Both private and public auditors are required to follow the same professional audit standards and comply with the same professional ethical standards. Nevertheless, there are some nuances between private and public audits in terms of the scope and nature of their work.

In the case of private audits, external auditors are auditing private organisations and are expected to provide reasonable assurance that the financial statements, as a whole, are free from material misstatements whether due to errors or fraud. The word reasonable indicates that auditors are not providing absolute assurance but a high level of assurance, meaning that there is an unavoidable risk that some material misstatements may not be detected in a properly performed audit. Materiality means that auditors are only responsible for detecting material fraud and errors but not necessarily every fraud and error (IFAC 2009). What is 'material' is essentially a matter of judgement. Accounting standards define something as material if, omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of financial statements make on the basis of those financial statements (ICAEW 2019).

However, unlike audits for private organisations, an auditor who is auditing a public organisation, may also go further to assess whether the public organisation is meeting its mission or objectives. A public organisation is generally a state-run and/or controlled organisation often financed by public taxation or funds. Public audit, goes much further than the basic requirements placed on auditors in the private sector. It assesses governance arrangements in audited bodies to prevent and detect fraud and corruption. Public auditors are also expected to focus on four audit dimensions namely, (i) financial sustainability; (ii) financial management; (iii) governance and transparency; and (iv) value for money. For example, audit work in public bodies would include reviewing, concluding and reporting on areas such as:

- the effectiveness of the financial planning systems in identifying and addressing risks to financial sustainability across the shorter and longer terms;
- the appropriateness of the arrangements put in place to address any identified funding gaps and whether the body can demonstrate that these arrangements are working; and
- whether the body can demonstrate the affordability and effectiveness of funding and investment decisions it has made (Audit Scotland 2016).

2. Public Audit in the UK

Public audit across the UK is wider in scope than the private sector, with additional opinions or conclusions required in relation to regularity and value for money arrangements. For audits of local public bodies in England, local auditors must provide an opinion on the truth and fairness of the financial statements of a local public body (in the same way as for private companies). However, public auditors are also required to provide an opinion on the regularity of public expenditure and provide an opinion on whether the public body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. Furthermore, certain public sectors such as National Health Service (NHS), Education, or Defence, where circumstances arise may:

- consider issuing a report in the public interest;
- consider whether to make a written recommendation to the audited entity (copying to the Secretary of State);
- consider the questions and objections raised by local electors in relation to the accounts of local government bodies;
- apply to the court for a declaration that an item of account is contrary to law; and
- consider whether to issue an advisory notice or to make an application for judicial review (ICAEW 2018).

Municipal public services account for a significant amount of public spending in the UK. For example, the financial year of 2017-18, 495 local authorities, local police and local fire bodies were responsible for approximately £54 billions of net revenue spending and 442 local NHS departments received approximately £100 billion funding from the Department of Health & Social Care. These local entities are also responsible for delivering many of the public services local taxpayers rely on every day. 'Local audit' is the statutory external audit of these local public bodies, which for local government include local authorities, such as county or district councils, fire and rescue authorities, police and crime commissioners, and chief constables. Local NHS bodies include local NHS trusts, NHS foundation trusts and clinical commissioning groups. Each year, local auditors give an opinion on whether local public bodies produce financial statements that comply with reporting requirements and are free from material errors, and conclude whether local public bodies have arrangements to manage properly their business and finances (NAO 2019a).

The UK parliament has long valued the role that auditors can play in "checking up" on government. The Westminster system of government establishes an independent auditor-general, who checks up on the activities of the executive arm of government and reports the results directly to parliament (Pearson 2014). The present framework of public audit in the UK is the product of a patchwork of legislation enacted over the past 150 years. The result is huge diversity of purpose, powers, organisation and methods between the public audit bodies. There are four national audit agencies, covering central government departments and agencies in England and Wales (the National Audit Office (NAO)), local government and health bodies in England and Wales (the Audit Commission), an audit body for Northern Ireland and another

one for Scotland. Each of the audit agencies has sought to develop a structure and approach that is sensitive and appropriate to the organisations they audit and to those to whom they report (Bowerman et al. 2003).

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland. The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance. The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government. Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament (Audit Scotland 2019).

In the UK, the scope of audits performed on the various bodies comprises two main areas:

- a) Providing an independent opinion on financial statements; and
- b) Review and reporting on the adequacy of audited bodies' arrangements in relation to the use of resources, in support of "Value for Money".

The Commission has produced a set of guidelines and criteria for performing the audits (the "Codes"), which are aligned with International Standards on Auditing ("ISAs") (UK and Ireland). APB Practice Note 10 provides further guidance on the application of audit standards for auditing public sector bodies in the UK. The Codes require auditors to issue a conclusion on whether the audited body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. In recognition of the potential issues associated with providing a conclusion on whether a body has made proper arrangements for Value for Money, the Commission has specified criteria for measuring bodies, as follows: - The organisation has proper arrangements in place for securing financial resilience; and - The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness (Department for Communities and Local Government 2013).

3. The Role of Public Auditors in Detecting Fraud – A Critical Review

3.1. Overview of fraud

Fraud in general is far from a new phenomenon and is estimated to cost UK £38.4bn a year, according to National Fraud Authority (2011, p. 3) and £110bn a year according to Crowe Report (Crowe, 2019). The 2006 Fraud Review conducted by the UK government positioned fraud as 'may be second only to class A drug trafficking as a source of harm from crime' (Attorney General's Office, 2006, p. 3). Fraud is recognised as one of the most prevalent and evolving crimes in the UK and presents significant losses to public sector funds. The financial

loss incurred in the public sector in the UK as a result of fraud is estimated to be over £10 million which is significantly less than the amount found in the private sector.

However, the impact of fraud goes beyond financial losses. Internal fraud committed by staff or suppliers of government services, for example, could lead to government agency's reputational damage, and loss of public's confidence in the government and the entire corporate governance system (UK Government Internal Audit Agency 2019). Fraud against individuals could lead to individual victim's loss of confidence and the ability to trust others.

There are many different types of fraud. Fraud could be committed internally by internal staff working for the organisation such as in the case of financial reporting fraud, asset misappropriation, or corruption. Fraud could also be committed externally by external individuals or organisations such as the case of organised crimes, cyber-attacks, or customer fraud. Fraud criminals are not only targeting private and public organisations but also individuals. Some of the most common types of fraud against individuals reported in the UK include application fraud, romance fraud, online banking fraud, and identity theft.

The importance and urgent need to tackle fraud are illustrated not just by the fiscal numbers involved but the significant damage which caused the collapse of multinational corporations in the UK including for example Bank of Credit and Commerce International (BCCI) and Barings Bank. Bernard Madoff was found guilty of masterminding a fraud of some £40bn, for which he was sentenced to 150 years imprisonment and 'Sir' Allen Stanford's \$7bn Ponzii scheme (US Securities and Exchange Commission, no date) resulted in 110 years of imprisonment (BBC News, 2012). Their fraudulent activities took place over two decades and these should have been evident to those responsible for accounting and auditing these organisations. Similarly, the impact of fraud in public sector can be detrimental not only to the integrity and sustainability of the organisation involved but also to the service users, some of whom are vulnerable members of the society. For example, a pharmacist, Michael Lloyd, was found guilty of fraud by tempering with prescriptions and overcharging the NHS (C+D News, 2019). If this was not discovered, the long-term effect of the fraudulent activity would hinder the financial sustainability of the health service.

3.2.The Role of Public Auditors in Detecting Fraud

3.2.1. Public Auditors Legal Liability in Relation to Fraud

Auditing is one of the specialised professional fields that oscillate between domestic laws and regulations and international professional standards. So, in dealing with responsibility of auditors in the UK, it is imperative to be aware that the legal framework of auditing regarding fraud detection, will attempt to be in harmony with international standards. In the United Kingdom, the fraud policy can be examined in three distinct parts:

1. Criminalisation;

2. Financial/law enforcement agencies; and
3. The reporting of suspected instances of fraud (Ryder, p. 123).

This chapter considers the first and third aspects of the fraud law and policy which are relevant for public auditors in the UK.

Criminalisation

Criminalisation of fraudulent activities has evolved over time, particularly by being subjected to the interpretations of various Theft Acts by courts. This trend derives partly from the fact that fraud is difficult to define. The designated statute, the Fraud Act 2006, does not define fraud directly, and provides instead that '[a] person is guilty of fraud if he is in breach of any of the sections listed' (s.1). Interestingly, there is no universal definition at common law either (Doig and Levi, 2009, pp. 199-215).

The City of London Police, which has been designated as the centre of excellence for fraud investigations, defines fraud as 'a criminal deception committed by a person who acts in a false and deceitful way' (City of London Police, 2008). However, SFO defines fraud as an 'abuse of position, or false representation, or prejudicing someone's rights for personal gain' (Serious Fraud Office, no date).

It may be argued that the Fraud Act 2006 has simplified the law by providing a new offence of 'fraud' instead of a variety of the ineffective deception offences which existed under Theft Acts (1968-1996) (Ormerod, 2007, pp. 193-219; Theft Act 1968, s.15, s.15A, s.16, s.20(2); Theft Act 1978, s.1, s.2(1)(a), s.2(1)(b), s.2(1)(c)) whereby it removed such crimes as 'obtaining a pecuniary advantage' and 'procuring execution of a valuable security' from the statute book. In practice, the range of deception offences created 'a hazardous terrain for prosecutors' which, consequently, encouraged reliance on 'conspiracy to defraud' (Ormerod, 2007, pp. 193-219). In the Fraud Act 2006, a person is guilty of fraud by: false representation (s.2); failing to disclose information (s.3); and abuse of position (s.4), which are considered in detail below. It worth noting that conviction under the Fraud Act 2006 carries a maximum sentence of ten years imprisonment or an unlimited fine or both (s.1(3)(b)).

Firstly, it is an offence to commit fraud by false representation (s.2) for example, by providing inaccurate information in audits to cover up malfeasant activity. 'A representation is false if (a) it is untrue or misleading, and (b) the person making it knows that it is, or might be, untrue or misleading (s.2(2)).' This test requires establishment of dishonesty, and intention 'to make a gain for himself or another, or to cause loss to another or expose another to a risk of loss' (s.2(1)(b) i & ii). Therefore, the intention of the perpetrator is key: an actual gain or loss does not have to take place. While what amounts to dishonesty is not provided by the Act, the courts have provided ample guidance in this regard: For instance, the judgment in *R v Ghosh [1982]* sets a two-stage test for dishonesty:

"The first question is whether a defendant's behaviour would be regarded as dishonest by the ordinary standards of reasonable and honest people. If answered positively, the second question

is whether the defendant was aware that his conduct was dishonest and would be regarded as dishonest by reasonable and honest people” (Fraud Act 2006, explanatory notes).

By representation, the Act ‘means any representation of fact or law including a representation of [any person’s] state of mind’ (Fraud Act 2006 s.2(3)). This can be done by expressed or implied acts which may include written, spoken or information posted on a website.

Secondly, fraud may be committed by failing to disclose information’ (Fraud Act 2006, s.3), whereby a ‘person dishonestly fails to disclose to another person information which he is under a legal duty to disclose’ (Fraud Act 2006, s. (3)a). Similar to the offence of false representation, there has to be an intention to cause gain or loss. The Law Commission has provided guidance in this regard:

“Non-disclosure of information should suffice if there is a legal duty to disclose it. Such a duty may derive from statute (such as provisions governing company prospectuses), from the fact that the transaction in question is one of the utmost good faith (such as a contract of insurance), from the express or implied terms of a contract, from the customer of a particular trade or market, or from the existence of a fiduciary relationship between the parties (such as that of agent and principal)” (Law Commission Report, para 7.28).

This provision should be clear to the auditors as they have a legal duty to report objectively and honestly.

Thirdly, fraud may be committed by abuse of position (Fraud Act 2006, s.4). by dishonest and intentional acts. This provision is also essential for auditors, as it recognises situations where a person ‘occupies a position where he is expected to safeguard, or not act against, the financial interests of another person’ (Fraud Act 2006, s.4(1)a) and covers situations where his ‘conduct consisted of an omission rather than an act’ (Fraud Act 2006, s.4 (2)). Examples of those in position of power include: Trustee/Beneficiary; Director/Company; Professional/Client; Agent/Principal; Employee/Employer; Partners. The Fraud Act 2006 does not apply in Scotland. In Scotland, criminal fraud is mainly dealt with under the common law and a number of statutory offences including: common law fraud; uttering; embezzlement; and statutory frauds. In Scotland, the term ‘fraud’ refers to the deliberate use of deception or dishonesty to disadvantage or cause loss to another person or party (Fraud Advisory Panel 2015).

These principles would apply in variety of circumstances *inter alia*, employee and employer; director and company; professional and client; agent and principal; business partners; within a family; or in the context of voluntary work (Law Commission report, para 7.38).

Reporting of suspected instances of fraud

An additional aspect of the anti-fraud eco-system in the UK is the obligation to report ‘suspected’ instances of fraud. However, the unenforced reporting regime and the lack of scope and consistency leave significant gaps in this approach. Despite the criminalisation of fraud by the Fraud Act 2006, there is no legal obligation to report suspicion of fraud unlike the legal duties to do so for suspicious activities under anti-money laundering and terrorist financing

regulations (MLR, 2017; Proceeds of Crime Act 2002, s.330; Terrorism Act 2000, s.19). In other words, fraud is only required to be reported if it is part of suspected money laundering or terrorist financing and/or if the business entity in question is regulated by the Financial Conduct Authority.

Sector specific obligations

Against this summary of the legal landscape which applies to auditors in the context of fraud, it is important to consider the sector specific obligations. These are provided by the Financial Reporting Council (FRC) which stipulates the auditors' responsibilities relating to fraud (FRC, 2017).

The FRC is the Competent Authority designated for auditing in the UK. The policy of the FRC "is to base its standards (ISAs (UK)) on the international standards set by the IAASB". However, when the need arises, 'additional requirements are established by the UK to address specific UK legal and regulatory requirements; and additional guidance can be provided that is appropriate in the UK national legislative, cultural and business context' (FRC 2016, p. 18). This does imply that even though the additional domestic requirements and guidance seek to augment the international standards, there can be a degree of variation of standards across international borders in relation to detecting fraud by auditors.

According to the Statutory Auditors and Third Country Auditors Regulations 2016, the applicable law and standards of FRC direct the scope and purpose of audit in the UK. What this suggests is that it is not only the law but also FRC's standards that determine the scope of work of auditors. For the ISA (UK) No.200, while the purpose "is to enhance the degree of confidence of intended users in the financial statements the scope of an audit does not ... constitute an assurance engagement with respect to the future viability of the audited entity or on the efficiency or effectiveness with which the management or administrative body has conducted or will conduct the affairs of the entity" (FRC 2016 p. 2). The interpretation of the 'purpose of an audit and the parties to whom the auditor owes a duty of care' can be found in case law such as in the case of *Caparo Industries plc v Dickman* [1990]. This case has a judgement that can be concluded that 'the ultimate purpose of audit relates to overseeing stewardship and governance'.

The achievement of the purpose is through "the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework". Usually, the auditor's "opinion is focused on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework" (FRC 2016, p. 2). In the company law of UK, the requirement for "true and fair" assessment and opinion "takes primacy over adherence to an accounting framework" or such auditing standards (Brydon Review 2019, p. 11). The basis for the opinion of the auditor is drawn from the reasonable assurance the auditor obtains "about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance... obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk ... to an acceptably low

level” (FRC 2016, p. 2). The opinion of an auditor, by these allocations, cannot therefore be said to be conclusive other than persuasive (*ibid*). To help clarify matters on scope of audit, ISA (UK) No.700 requests that the specific description of the scope of responsibilities of the auditor should be added to “the auditor’s report, either by way of cross-reference or directly within the report itself” (FRC 2016 p. 18).

Public and private auditors are required to comply with the same set of professional audit standards. The International Standards on Auditing and the professional audit standards in England and Wales require auditors, whether private or public, to detect material fraud and error that are more likely to impact the reliability and fairness of the financial statements. For that purpose, the auditors are required to assess and respond to the risk arising from two types of fraud that are considered to have an impact on the financial statements: (i) Financial reporting fraud and (ii) asset misappropriation.

For instance, the International Auditing and Assurance Standards Board (IAASB) issued the International Standard on Auditing (ISA) No.200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* that stated that “external auditors are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error” (para.5, p.3). IAASB also issued ISA No. 240 *the Auditor’s Responsibility Relating to Fraud in an Audit of Financial Statements* that requires external auditors to assess and respond to fraud risks arising from only two types of internal fraud “asset misappropriation and financial reporting fraud”. ISA No. 240 (2010) thus requires external auditors to: (a) identify and assess the risks of material misstatement of the financial statements due to fraud; (b) obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and (c) respond appropriately to fraud or suspected fraud identified during the audit

ISA No.240 also requires external auditors to assess and respond to the risk of financial reporting fraud and to categorise that risk into three categories: risk of motives/pressure to commit fraud, risk of opportunity to commit fraud, and risk of rationalisation of fraud (para A25, p.187). External auditors are also required to consider management’s integrity while assessing the risk of financial reporting fraud (para A64, p.186). The standard requires external auditors to use professional scepticism throughout the audit and to consider the risk of management override of controls (ISA No.240, para 8, p.159). Professional scepticism is defined by ISA 200: “*Overall objectives of the independent audit and the conduct of an audit in accordance with international standards on auditing*” (2009, Paragraph 13) as “An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence”. ISA No.240 (2010) states that:

The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees (para 7, p.159).

As for reporting suspected fraud, ISA No.240 requires external auditors to communicate any fraud related matters to management and those charged with governance on a timely basis. If external auditors suspect that management or those charged with governance might be involved in fraud, the standard requires auditors to determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity.

The standard then states that:

Although the auditor's professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances. (ISA No.240, Ref: Para. A65–A67, p.166)

ISA No.315 *Assessing the risk of material misstatements* requires a discussion among the engagement team members and the engagement partner about how and where the client's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur (2009, para. A10–A11).

The FRC's international standards on auditing (ISA) provide that material (intentional) misstatement results from fraudulent financial reporting and from misappropriation of assets and "the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management". This approach neglects the fact that auditors can be held accountable and liable for fraud and/or failing to detect fraud and puts the responsibility test on merely "obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error" (*ibid*). The ISA provides a number of sound details about characteristics of fraudulent activities, fraud risk factors, the challenges that auditors face in detecting fraud and lists procedural steps of auditing practices. In doing so, ISA No.240 defines fraud as "an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage" (*ibid*). It is not clear, given the date of the ISA (July 2017), why the ISA does not refer to the over-riding legal definitions of fraud under the Fraud Act 2006.

If the auditor identifies a misstatement, s/he "shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognising that an instance of fraud is unlikely to be an isolated occurrence" (*ibid*, para. 35). If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and If the auditor withdraws:

- (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Two critical details in the ISA with relation to public auditors can be identified as follows: "when a [public] auditor suspects or has reasonable grounds to suspect that irregularities, including fraud with regard to the financial statements of the entity, may occur or has occurred, the auditor shall, unless prohibited by law or regulation, inform the entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future". ISA No. 240 also states that:

the public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements but may also include a broader responsibility to consider risks of fraud.

A similar statement is made again under para A67:

In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority.

While the ISA No. 240 does not provide any further detail or examples as to what this 'broader responsibility to consider risks of fraud' may be, it does recognise the EU legal principles (Regulation, (EU) No 537/2014) pertaining to public entity reporting and states that disclosure in good faith to the authorities responsible for investigating fraud shall not constitute a breach of any contractual or legal restriction on disclosure of information in accordance with the Audit Regulation (ISA, No. 204, para. A66-1).

3.2.2. The Need for Audit in Reducing Fraud Risk

There is no doubt that fraud is a serious issue, yet the role and duties of public auditors were not conceived as 'anti-fraud agents' in their original inception. While the UK courts penned fraud detection as one of the key objectives of an audit as early as the 19th Century (*London and General Bank*, 1895),ⁱⁱ the judges were also prepared to assert that auditors could not be expected to uncover all fraud committed within an organisation, since the auditor was not an insurer or guarantor, but was expected to conduct the audit with reasonable skill and care in the circumstances. Following such earlier recognition of auditors as enablers in countering fraud, it was generally accepted that the management, rather than auditors, had the ultimate responsibility to prevent and detect fraud as the responsibility to implement necessary internal control systems to prevent fraud in their organisations rested with them (Alleyne and Howard, 2005).ⁱⁱⁱ Coupled with this fact, the increase in number and volume of business transactions nationally and internationally meant that it would be unreasonable to expect auditors to

examine all transactions and detect fraud. Thus, the key aim of an audit was recognised as the 'verification of company accounts' (Vanasco, 1998, pp. 4-71), and auditors followed this line of thinking in order to minimise their legal culpability or liability and protect themselves from litigation which may result in them being found guilty of fraud (*ibid*).

Such attitudes towards the role and duty of auditors have begun to change owing to a number of socio-legal and socio-economic factors from 1990s onwards. One of the factors has been the recognition that financial sector professionals are fundamental components of every developed economy and integrity in organisations, and economic development cannot be achieved without the services (Cohn, Fehr and Maréchal, 2014, pp. 86-89; Levine, 1997, pp. 688-726) they offer. With this importance also comes responsibility of countering financial crime, including fraud, bribery and corruption. Garland (1996 p. 452) has described this trend as the 'responsibilization strategy' (Garland, 1996, p. 452; Cit. O'Malley, 1992 and 1994). Being experts, auditors (among other key professionals) are called upon to act to a certain extent as independent 'gate keepers' of surveillance and law enforcement agents of the state (Wadsley, 2008, pp. 65-75). In tandem with this public duty, they are required to be loyal to their clients who pay their fees. Furthermore, it should not be underestimated that the methods employed by auditors may put a veil over fraud and money laundering activities by encouraging the perception that companies are not corrupt and are accountable to various stakeholders (Sikka, 2007, pp. 269-95).

An additional factor, which has brought the role and duties of auditors to the forefront as anti-fraud agents, is the wide spectrum scandals which unfolded in the last two decades including, Enron and Worldcom, Panama Papers, SwissLeaks, LuxLeaks, LIBOR, etc. These events led to the increased acceptance that auditors (and accountants) who have access to the granular details of business activities and transactions shall have legal duty to detect and/or report suspicious activities to the relevant authorities^{iv} and to assist them in tracing and recovering criminal assets. It is worth noting however that while auditors and accountants are assumed to be the guardians of society and are somehow expected to be at the front line of the defence against financial crimes such as fraud, the success rate of criminal convictions emanating from these key professionals in relation to financial crimes in many developed countries is extremely low (ECOLEF Project, 2013; Eurostat, 2013). This indicates that creation of legal duties is not enough to engage such enablers effectively in the anti-fraud strategy and policy.

According to the agency theory, agency relationships apply where one party, the principal, delegates authority, especially control over resources to another, the agent. An example of these relationships is between a company owner and a manager, but they also apply at several levels in the public sector. When agency relationships apply, there are costs in monitoring. Agents might be self-interested and spend money for their own benefit or perhaps take decisions that conflicts with the interest of principles. Auditing is valuable because it reduces the risk of fraudulent behaviour and information asymmetry as a result of agents' different motives which may not align with the principles' best interests, thereby increasing confidence in the information provided by agents (Hay and Cordery 2018). The role for audit will always mirror

the public sector. Whether audit fulfils this role depends on having the right legislation and the right approach (Pearson 2014).

Auditors act as a deterrent of fraudulent behaviour due to the perception of fraud detection. Potential fraudsters are less likely to commit fraud, if they believe someone is watching them and that they are more likely to be caught (Wells 2013). Auditors, whether private or public serve as one of the few credible sources of external governance mechanisms capable of discouraging opportunistic behaviour of managers (Chen et al., 2013; ICAEW, 2005). In a study conducted by the ACFE in 2016, findings revealed that the presence of anti-fraud controls was correlated with both lower fraud losses and quicker detection and that external audits of the financial statements were the most commonly implemented anti-fraud control.

The previous section clarified the role of auditors in detecting fraud. Although the main responsibility of audit is not to detect fraud, auditors cannot ignore the fact that they are among the parties that can detect fraud at the earliest stages (Smith and Baharuddin 2005). For example, if auditors conducted proper fraud risk assessment during the audit of financial statements, as required by the professional audit standards, this could at least alert stakeholders to red flags for fraud early enough so that corrective actions to mitigate fraud risk could be taken into consideration. In addition, although auditors cannot detect all types of fraud because of its collusive nature, this does not give them an excuse to refrain from looking for it (Zikmund 2008).

The public needs assurance that when they pay their taxes, the money spent by local public bodies will be spent properly, that there will be transparency and accountability in how that money is spent and how services are delivered. The integrity of financial statements and how government bodies spend public money is therefore important in building trust and confidence in the public sector. One way that the public builds this trust is knowing that there is an external audit carried out of each local public body and that the audit opinion provides assurance that the information in the financial statements presents fairly or shows a true and fair view of how that money has been raised and spent (ICAEW 2018). The role that public auditors play is therefore very important.

In the UK, local service users, taxpayers and others with an interest in the performance of local public bodies want to be confident that those entrusted with public money are properly accountable for their decisions and actions. This is why the UK Parliament has determined through legislation that there should be independent external assurance about how public bodies spend taxpayers' money. Consequently, publicly funded local bodies – such as councils, police bodies, fire and rescue authorities and health bodies – on which local people depend for financially sustainable services are subject to independent audit of their accounts and arrangements for securing value for money (NAO 2019a).

Good governance in the governmental context is based on democracy, rule of law, which in the European Union context is captured by the principle that the European Union is a community of law, fundamental rights and freedoms and on the constitutional values of public

administration and service. Good public governance requires also capacity to reform. Public audit shall be a mean to enhance effectiveness and reform needed for this and a mean to enhance ethics and values which also create successes for reform. Effectiveness of public audit in the assurance and enhancement of the democratic values, good governance and good level of effectiveness and performance requires a close link between audit and the use of audit findings in the government and in the exercise of the legislative and budgetary power (National Audit Office 2007). It is essential that local public bodies manage their resources well, so that they can achieve their desired outcomes with the resources that are available. Independent external auditors therefore have a key role in supporting effective stewardship, governance and accountability. This role is important at any time, but especially so when available resources are scarce (NAO 2019a).

3.2.3. Audit expectation, quality and delivery gaps

Since the mid-19th century when company auditing began, there have been difficulties in clearly demarcating the role of the company's auditor in detecting fraud. The nature of legal position of fraud is that "the auditor does not make legal determinations as to whether or not fraud has occurred" (FCR, 2016 p. 35). This is particularly so because the Companies Act 2006 does not explicitly refer any duty for the auditor in detecting fraud. ISA (UK) No.240, which is a standard for addressing auditors' responsibility for fraud detection in a financial statement audit, urges "auditors to focus on intentional misstatement of the financial statements, arising from either fraudulent financial reporting or misappropriation of assets". In this regard, the FRC states that the responsibilities of the auditor "are to obtain reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error... The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control".

Academic research (Kassem and Higson 2016) argues that the role of external auditors with regards to corporate corruption was neither given enough attention in the literature nor clearly defined in the audit standards. For instance, none of the current professional audit standards make a direct reference to external auditors' responsibilities with regards to corporate corruption that was only implicitly implied and in some instances seemingly ignored, assuming that corruption has no impact on the financial statements like in the case of ISA No.240 as explained above. Corrupt employees can cause employers to overpay for goods and services bought by a company in which the employees have a hidden interest. This form of corruption is called "conflict of interest." These conflicts of interest can also lead to writing off sales through the use of discounts or allowances. most bribery involves disbursement of cash and the recording of that disbursement in the financial records (Wells 2011).

Because of the complexity in clearly identifying and actualising the responsibility of auditors to detect fraud, there has been an inherent 'expectation gap'. This gap, according to the FRC (2016), denotes "a perceived difference between what users of financial statements and the public expect from an audit, and what an audit is required to deliver under existing UK law and auditing standards" (FRC, 2016 p. 13). The expectation gap is not only found amongst the

public but also in academic discourse and case law. So instead of holding the directors and shareholders of a company directly responsible as the primary agents for development and implementation of rules, the argument goes, the auditor is blamed for any failure to detect fraud which may be concealed by management of the company (*ibid*). Even though it is not the primary legal responsibility of the auditor to detect fraud, the call made by the ISA No.240 is that auditors should “include methods for identifying potential cases of fraud when planning and conducting the audit” (CIMA, 2008 p. 33). Auditors accordingly have to give consideration to procedures such as ‘discussing the risk of fraud with management and those charged with governance; discussing with the audit team the susceptibility of the accounts to material misstatements due to fraud’; as well as considering whether one or more fraud risk factors are present’ (*ibid*).

The following instances are cited by the FRC (2016) as expectation gaps of audit (thus, expectations of audit which are unmatched or unmatched fully by the corresponding statutory and regulatory framework): ‘auditor will have actively sought out any evidence of fraud; audit will provide assurance over the sustainability of an entity or its business model (the going concern assurance); and that audit will cover all financial and non-financial information published in an entity’s annual report and accounts’ (FRC, 2016, p. 13).

When turned to the other side of the responsibility coin, there are those such as the Business, Energy and Industrial Strategy Committee (BEIS Committee) that articulate the possible existence of a “delivery gap” (House of Commons, 2019, p. 14), which either is a consequence of procedural deficiencies, incompetence of auditors or dereliction of duty by auditors. Thus, the delivery gap is the difference between what auditors are charged to do as a responsibility and the poor discharge of duties thereof because of procedural defects and/or low skillset and poor attitude of auditors. With respect to structural deficits, for instance, the FRC’s thematic review of auditors’ work in 2018 revealed that “the nature, extent and quality of the work performed varied considerably, both between and within audit firms, ... [which was] linked ... to a lack of prescriptive requirements for auditors” (FRC, 2016, p. 24). This further generates an expectation gap (*ibid*). So, the argument is that the challenge with auditor’s responsibility is more about audit quality gap rather than expectation gap, really.

Indeed, the FRC has categorised audit quality into two: “the quality of the auditor’s performance against whichever standards or principles have been agreed and the quality of the audit output in meeting the legitimate demands of those for whom the auditor’s report is intended” (FRC 2016, p. 25). Thus, performance in relation to standards and the nature of output in relation to the demands of users. Observed more closely, both expectation and quality gaps can be substantiated, to some extent. They are, indeed, interrelated. Inevitably, the audit quality gap does exist since auditing is a human process that is fraught with exposures to fallibilities. Essentially, if ‘audit effectively fulfils its legal requirements and standards, it is possible for the expectation gaps to be narrowed or disappeared’ (FRC, 2016).

Therefore, the expectation gap (House of Commons 2019, p. 14), which draws our attention to the lacunae in the understanding and real scope of the law and auditing standards, must be addressed by taking a closer look at the quality of compliance to FRC’s standards and the

Companies Act 2006. This should address the quality and delivery gaps. But beyond that, the adequacy of the legal rules and standards relating to fraud detection by auditors must still be addressed.

In order for auditors to conduct an effective fraud risk assessment and thereby quality audit, they have to maintain their independence and objectivity at all times. Auditors are required by the professional audit standards (ISA NO.200) to maintain an independent mental attitude and professional scepticism throughout the audit. The International Standard on Audit (ISA) No.240 requires auditors to detect material fraud and error; assess the risk of fraud and respond to that risk; brainstorm with the audit team about the susceptibility of the audit client to fraud risk; and to assess management integrity. Nevertheless, recent fraud scandals in the UK (e.g. Tesco; BHS; Carillion; Patisserie Valerie) and in other countries (e.g. BT Italia; Nissan) around the world raise doubts about the credibility of audit whether in the private or public sector, particularly in relation to material fraud detection.

The collapse of Carillion in 2018 in the UK, for example, has led to increase in political and public scrutiny of the audit profession, and has eroded trust in auditors (ICAEW 2019). It was argued that in the past few years audit failure runs deep and wide after an accounting ‘black hole’ was discovered in the company’s books, estimated at £94 million. In the case of BHS, 11,000 workers lost their jobs, and 19,000 current and future pensioners initially faced seeing their pensions cut. By May 2018, the collapse of Carillion had led to the loss of over 2,000 jobs, with over 27,000 pensioners facing reduced pensions, £2 billion owed to 30,000 suppliers, unfinished projects, and a cost to the tax payer of £148 million. Similarly, the collapse of Patisserie Valerie into administration resulted in the closure of 71 stores and the loss of over 900 jobs (House of Commons 2019). Speaking ahead of the event at ICAEW 2019, Rachel Reeves MP, Chair of the Business, Energy and Industrial Strategy Committee said:

Misleading audits have been at the heart of corporate failures over recent decades. Recent accounting scandals at BHS, Carillion, and at Patisserie Valerie have shown accounts bearing closer resemblance to works of fiction than an accurate reflection of the true financial performance of the business. Repeated accounting failures have contributed to the collapse of major businesses and undermined public and investor confidence

Nevertheless, despite audit failures in the recent fraud scandals, auditors are still denying their responsibility for detecting material fraud. This has led to severe criticism of the auditor’s role in corporate governance and the value of audit. Warnings are being voiced out about the soundness of the local audit regime particularly across the UK. In his independent review of the Financial Reporting Council, Sir John Kingman noted that Public Sector Audit Arrangements (PSAA) were prioritising cost reduction over audit quality. This is especially concerning at a time of extreme financial pressure and rising speculative investment by councils (FRC 2018). The House of Commons stated in their recent report that:

Fraudulent reporting by directors is almost always material, by nature if not by size. The detection of material fraud is, and must continue to be, a priority within an audit. Audits must state how they have investigated potential fraud, including by directors (House of Commons 2019).

Another major issue within public audit practice in the UK is that some of the organisations financed by public money are audited by one of the four public audit organisations while others can appoint their own auditors from the private sector accounting firms and not all bodies are subject to performance auditing. In addition, in the UK, the framework for public audit has become increasingly inconsistent and fragile. Indeed, rather than a culture of co-operation, there are clear indications that the various national audit bodies are resisting to maintain their existing roles and gain desired shares in newly created public sector audits and inspections. While encouraging auditors to act as the whistle blowers and/or fraud investigators for failing public services provided by such bodies, the government appears quite reluctant to allow public auditors to focus similar attention on the Executive branch of the government. As such, it can be argued that central government has done much to intensify existing tensions and inconsistencies in the public audit function which have important implications for auditor independence (Bowerman et al. 2003).

The National Audit Office (NAO) has noted that while public auditors are increasingly highlighting weaknesses, these are often met with inadequate or complacent responses and that auditors are not using the full range of additional reporting powers at their disposal (NAO 2019b). Policing and combating fraud, which is by definition a criminal offence, is not the sole responsibility of auditors but requires collaborative efforts from the government, law enforcement agencies and judiciary. It is clear that high quality audit could act as a deterrent of fraud as explained earlier, and hence auditors need to improve their skills in material fraud detection or at least in reporting early signs for fraud.

Even though audit is mentioned several times in the Companies Act 2006, “there is currently wide debate as to whether the law functions effectively in this area” (FRC, 2016, p. 28). Some CEOs have had to doubt the capacity of the legal regime of auditing for detecting fraud in the UK. For instance, the CEO of auditing firm Grant Thornton, David Dunckley, has, in February this year, argued before UK Members of Parliament that ‘auditors are not in search for fraud in companies’ (Badenhorst, 2019). For Dunckley, the present procedures for auditing are structurally deficient to detect fraud, since they merely gear towards reaching a conclusion whether the accounts of companies ‘are reasonable’ (Badenhorst, 2019). Admitting the expectation gap between what audit firms do and what may be expected of them by the public, Dunckley asserted thus: “We are not looking for fraud and we are not looking at the future and we are not giving a statement that the accounts are correct. We are saying they are reasonable; we are looking at the past, and we are not set up to look for fraud” (*ibid*).

This assessment is not only a plausible legal position of mandate of auditors but also it has been affirmed by subsequent review conducted on auditing gaps in the UK (FRC, 2016). However, Dunckley’s position neither go down well with most of the MPs nor did it resonate well with case law and the views of the then Chief Executive of the FRC, Stephen Haddrill. Indeed, Haddrill, completely rejected the assertion made by Dunckley by stating that, there is ‘a clear responsibility of auditors to spot fraud’. Clarifying Haddrill’s contention, Sikka (an academic) averred that even though the responsibilities of auditors are not clearly codified in

law particularly in the Companies Act 2006, the legal precedent is clear that auditors are required to “to sniff out fraud” (Badenhorst, 2019).

Sikka particularly supported this position by the judgement in *Fomento (Sterling Area) Ltd. v Selsdon Fountain Pen Co Ltd* [1958] that: the vital task of the auditor “is to take care to see that errors are not made, be they errors of computation, or errors of omission or commission, or downright untruths”. In this regard, Lord Denning (para. 23) pushed for the auditor to have the “inquiring mind” rather being passive. Although the audit standard provided by the FRC supports this ruling, the FRC’s focus is on auditor’s responsibility to obtain ‘reasonable assurance that the whole of financial statements are devoid of material misstatement caused by fraud or error’. What then is the case when the ‘misstatements are immaterial’ which assumes the sophisticated form of fraud which managers can manipulate and hide from auditors?

Subsequently, much as Dunckley’s assertion may not be completely founded when it comes to case law and industry standards, some case law and auditing practice are more inclined to the observation made by Dunckley as CEO of Thornton (Financial Times, 2010). Thornton in 2010, had been involved in a New York Appeal Court’s case relating to the legal liability of auditors to detect fraud committed by the auditee, shareholders/managers/employees (Financial Times, 2010). In denying culpability, this case relied on the legal doctrine that is derived from *pari delicto* (“in equal fault”) principle that a faulty company does not have the right to sue a perceived faulty auditor (even if the auditor admits that they have failed in their duty to detect the fraud) (*ibid*). For instance, in *Stephens v Stone* [2009], the House of Lords (now the UK Supreme Court) dismissed the claim of negligence that was brought against an audit firm for having allegedly failed to spot a fraud at a trading company, Stone & Rolls Ltd which subsequently collapsed. The House of Lords held that the liquidators, whose action would have inured to the benefit of Stone & Rolls Ltd, could not succeed in their claim for damages because the Stone & Rolls Ltd was itself responsible for the fraud in question. This case highlights the delicate relationship between the responsibility to detect (statutorily or by standards) and the liability of a public auditor for failing to detect fraud that has been committed by the auditee company itself.

Nevertheless, the most recent case of *Assetco Plc v. Grant Thornton UK LLP* [2019] has established an instructive rendition of the key legal responsibilities of both the company’s directors and auditors regarding ‘the preparation and auditing of financial statements’ (FRC, 2016). With respect to the legal duties of the auditor, for instance, the court agreed that the auditor is required by parts 15 and 16 of the Companies Act 2006 to:

- (1) To have regard to the directors’ duty only to approve accounts giving a true and fair view, when carrying out their functions (s. 393(2));
- (2) To state whether, in the auditor’s opinion, the annual accounts give a true and fair view, have been properly prepared in accordance with the relevant financial reporting framework, and have been prepared in accordance with the requirements of the Act (s. 495); and
- (3) To carry out such investigations as will enable the auditor to form an opinion as to whether adequate accounting records have been kept by the company, and whether the accounts agree with the accounting records (s. 498(1)).

The above judgement has shown that the duty of the auditor to detect fraud is not clearly spelt out by the provisions of the law. However, according to Justice Bryan in the *Assetco Plc v. Grant Thornton UK LLP* [2019], the auditor has, the “duty to act with professional scepticism” in order to discover possible dishonesty and concealment in the process of auditing.

So, can the auditor be held liable for not detecting fraud? The exposure of the auditor to liability does exist in respect of the failure of the auditor to detect issues (which are of course may be there) “with the reliability of the financial statements, and/or drawing conclusions for which there is no reasonable basis” (FRC 2016 p. 37). For instance, if fraud were to be part of the issues expected to be discovered, failure to detect fraud which surfaces later could result in liability by the auditor as obtained in the most recent case *Assetco Plc v. Grant Thornton UK* in which about a whopping £21 million in damages were awarded against Grant Thornton UK in favour of AssetCo Plc (this was the second largest award by a court against an auditor in the UK).

Because of the lack of clarity in responsibility and liability regarding auditor’s role in detecting fraud, ICAEW has been advising companies to, as a safeguard, “include a so-called ‘Bannerman paragraph’ in their auditor’s reports to help limit their potential liability” (FRC, 2016, p.37). This should include what the audit sets out to do and what it is not expected to do in the light of the legal position on the expectation of the auditor. This advice is within the law. The Companies Act 2006, permits “contractual limitation of liability (through a Limited Liability Agreement, or LLA, between the auditor and the company) [which] require annual shareholder approval and are also subject to an overarching “fair and reasonable” test to be applied by the courts” (FRC, 2016, p. 37).

Drawing on the above discussions we believe that the audit expectation gap will continue to increase as long as there is a lack of clarity in the responsibility and liability of auditors with regards to fraud detection. The language of the audit standards needs changing to reflect the significance of fraud risk assessment and its impact on audit quality. Professional bodies should also embed anti-fraud education into their professional curriculum and training to help improve the auditors’ skills in material fraud detection. Audit regulators such as the FRC needs to be more strict in its audit inspections and the sanctions imposed on audit firms that do not properly assess fraud risk and/or detect material fraud.

Conclusion

The current legal regime and ecosystem of auditing standards suggest that even though the auditor can be responsible for detecting fraud, the auditor may only be liable for failure to detect fraud when it has been determined that the auditor did not apply ‘professional scepticism’ (*Assetco Plc v. Grant Thornto*, 2019) and “inquiring mind”(Fomento v. Selsdon, 1958) in the course of discharging its duties according to the Companies Act 2006 and FRC or industry standards. The FRC found that “the statutory provisions relating to auditors’ liability continue to represent a barrier to making significant changes to auditors’ responsibilities which may be in the public interest” (FRC, 2016, p. 39).

It is worth noting that ‘the parties to whom auditors might be responsible can be different from the parties whom the auditors could be liable for any failure’. In effect, the Companies Act 2006 requires enhancement to make the ISA standards and case law more biting in respect of the liability of public auditors to detect fraud in companies. However, with emergence of technological solutions for detecting fraud, strong internal controls which utilise technology could quite easily make auditors detect any errors on financial arrangements by the auditor, including fraud.

We recommend that in order for private and public auditors to conduct effective fraud risk assessment, they need to consider the factors that enable fraud to be committed. This includes lack of integrity across the organisation, the motives of fraud perpetrators, the opportunities available for fraud perpetrators, and their capabilities to exploit opportunities for fraud. Although audit standards require external auditors to consider most of these factors (as per ISA No.240 standards), research indicates that auditors hardly consider the motivations for fraud or management integrity in their fraud risk assessments (Albrecht et al 2008). Management motives are key antecedents for fraud perpetration (Kassem 2017), and therefore, auditors need to consider them in the assessment of fraud risk. The value of external audits is also weakened when a client’s integrity is questionable (Jamal et al., 2014). Stakeholder’s confidence in the independence of external auditors is strongly linked to their confidence in an auditor’s ability to challenge management; unfortunately, this function does not seem to be an essential element expected from external auditors (FRC 2016).

Regulators also have a role to play in protecting auditors’ independence whether in the private or public sectors. Audit fees and audit rotations are still major issues that are more likely to impair auditors’ independence. The language of the audit standards is also in need of change to reflect the importance of conducting effective fraud risk assessment and response. Auditors should be required to report on the effectiveness of internal controls, particularly anti-fraud controls designed to either prevent or detect fraud. This was one of the suggestions in the recent call for views submitted by Sir Donald Brydon in relation to the quality of audit in the UK (See Brydon Review, 2019).

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ⁱ US Securities and Exchange Commission (no date) Ponzi Schemes: What is a Ponzi Scheme? 'A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity.' <http://www.sec.gov/answers/ponzi.htm> accessed 11 October 2011.

ⁱⁱ In the case of *London and General Bank* (No. 2) [1895] 2 Ch. 673, the judge stated that it was the auditor's duty to report to shareholders all dishonest acts which had occurred, and which affected the propriety of the contents of the financial statements. Also see, Porter, B. (1997), "Auditors' responsibilities with respect to corporate fraud: a controversial issue", in Sherer, M. and Turley, S. (Eds), 3rd ed., *Current Issues in Auditing*, Paul Chapman Publishing, London, Ch. 2, pp. 31-54; and Ramos, M. (2003), "Auditors' responsibility for fraud detection", *Journal of Accountancy*, Vol. 195 No. 1, January, pp. 28-36.

ⁱⁱⁱ Alleyne P. and Howard M. (2005), "An exploratory study of auditors' responsibility for fraud detection in Barbados", *Managerial Auditing Journal*, Vol. 20, No. 3, pp. 284-303. Also note that the UK National Audit Office (NAO) defines its role as: to hold government to account for the way it spends public money with the statutory authority to examine and report to Parliament on whether government is delivering value for money on behalf of the public, concluding on whether resources have been used efficiently, effectively and with economy. There is no mention of fraud.

^{iv} This shift has been expressed in many legal instruments including anti-money laundering laws, reporting standards, and auditing regulations.